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RUEHCHI/AMCONSUL CHIANG MAI 0301  
RUEHGZ/AMCONSUL GUANGZHOU 0574  
RUEHHM/AMCONSUL HO CHI MINH CITY 0129  
RUEHHK/AMCONSUL HONG KONG 8599  
RUEHGH/AMCONSUL SHANGHAI 1388  
RUEHSH/AMCONSUL SHENYANG 6097  
RUEATRS/DEPT OF TREASURY WASHDC  
RUCPDO/DEPT OF COMMERCE WASHDC  
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C O N F I D E N T I A L SECTION 01 OF 03 TAIPEI 002284

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KATZ, TREASURY FOR OASIA/TTYANG AND HAARSAGER, COMMERCE FOR  
4431/ITA/MAC/AP/OPB/TAIWAN

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TAGS: [ECON](#) [EFIN](#) [ETRD](#) [PREL](#) [TW](#)

SUBJECT: U.S. TREASURY OFFICIALS HEAR CALLS FOR MORE  
LIBERALIZATION

Classified By: Economic Chief Hanscom Smith for reasons 1.4 (b) and (d)

11. (C) SUMMARY. In the first visit of U.S. Treasury officials to Taiwan in more than two years, East Asia Director Mathew Haarsager and Taiwan Desk Officer TT Yang met with a variety of Taiwan financial sector authorities, economists, and U.S. and local business people. Business people and economists argued for faster cross-Straits liberalization and service sector reforms, especially in the financial sector. Most interlocutors expected more cross-Straits liberalization after the March 2008 presidential elections. Financial regulators and the Central Bank discussed possible tax reform and bank policy and predicted another rate hike. END SUMMARY.

12. (SBU) U.S. Treasury Office of East Asia Director Mathew Haarsager and Taiwan Desk Officer TT Yang's September 26-28 visit to Taiwan included meetings with the Chunghua Institute for Economic Research (CIER), the Taiwan Institute of Economic Research (TIER), the Council for Economic Planning and Development (CEPD), the Central Bank of China, the Mainland Affairs Council, the Ministry of Finance, the Financial Supervisory Commission, the American Chamber of Commerce, and private sector banking and financial experts. This was the first visit by U.S. Treasury officials to Taiwan in more than two years.

Amcham Asks For Tax Agreement and Liberalization

13. (SBU) In a breakfast meeting with Amcham members mainly from the financial sector, U.S. firms complained that Taiwan was missing significant opportunities to grow its economy by moving too slowly on cross-Straits liberalization and failing to push reforms that would allow for development of the service sector. Some argued that Taiwan had a "bifurcated economy" with high-tech firms and China-related businesses doing very well and "everything else" not. Further, Taiwan,s

economy was losing competitiveness regionally, hampered by non-transparent and poorly implemented regulation.

14. (SBU) Amcham members stated regulators were moving far too slowly to rationalize the financial sector, noting that 50% of the banking sector is still controlled by state-owned banks. One banker described the banking industry here as "too liquid, too crowded and too competitive." Foreigners are still buying banks here, however, because the market is potentially very lucrative, and with a freeze on new branches, that is the one way foreign banks could expand here. A number of foreign banks are hoping to attract Taiwan firms with operations in China that cannot be served by local Taiwan banks. (Note: Taiwan banks are not allowed to operate in China. End note). Business representatives argued that Taiwan regulators should better consult foreign banks, who are often "more advanced operators" compared with their local counterparts. Instead, regulators tend to rely on consultations with local business groups in which foreign firms have little or no voice.

15. (SBU) The Amcham representatives uniformly stressed the importance of a U.S. - Taiwan bilateral tax agreement. One tax expert stated many instances of double taxation occur, particularly when U.S. firms bank more profits in the U.S. In this process, the Taiwan authorities refuse to permit firms to adjust profits here, creating a double taxation issue. She called it "not a small problem" and noted in one recent case the amount of tax in dispute totaled about USD 4 million.

Central Bank Reserves Appropriate, Capital Outflow Won't Continue

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16. (C) Central Bank Deputy Governor George Chou told Haarsager that at US \$261 billion, Taiwan's foreign exchange reserves are at the appropriate level for forex management and other needs. Chou stated that Taiwan has no plans to create a sovereign wealth fund, and agreed with Haarsager that Sovereign Wealth Funds need to be as transparent as possible in their governing structure and investment objectives.

17. (C) Chou noted that the Central bank is keeping its eye on inflation and capital outflows. M2, the measure of money supply that the bank watches most closely, has so far grown well within target rates this year. With "moderate price pressures," however, the Central Bank increased interest rates by an eighth of a percentage point in September. Chou pointedly mentioned that many people believe that the bank will increase rates again. While stressing Taiwan permitted free flow of capital, he noted that capital outflows had been particularly large in May - August of this year. (Note: Published figures not yet available. End Note) The narrowing differential between U.S. and Taiwan interest rates, as well as improving Taiwan stock market performance in the run up to the election, should reduce these outflows, he stated.

Fiscal Policy

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18. (C) In separate discussions of fiscal policy, both Vice Minister of Finance Liu Teng-cheng and CIER president Hsiew Dai-chi outlined Taiwan's efforts to make the tax system more uniform by removing subsidies and lowering rates. This effort is not to lower Taiwan's already low tax burden of about 14% of GDP, but to make the system more equitable. Liu noted that Taiwan has no plans for significant increases in social spending. Haarsager observed that greater social spending could translate into reduced savings and greater domestic demand. Various interlocutors, however, indicated that due in part to trade's sizeable share of the economy and limited progress on liberalizing the service sector, domestic

demand is unlikely to be a significant source of growth over the short and medium term.

#### Light at the End of a Long Tunnel?

¶9. (C) Private sector banking contacts and think tank economists said the banking sector is hampered by restrictions on doing business in China. Taiwan banks are losing out to foreign competitors who are able to provide a full range of services to customers doing business in China. At a September 27 dinner, Fubon Bank senior executive Jesse Ding indicated that Fubon has had limited progress in its proposal to use the Hong Kong Monetary Authority (HKMA) as an intermediary in using Fubon's Hong Kong subsidiary to buy a stake in China's Xiamen City Bank. (NOTE: Ding did not go into detail, but his comments jibe with what we have recently heard in a separate conversation with another top Fubon executive.) Although Ding and Taishin Financial Holding President Keh Hsiao Lin were encouraged by the prospects of more cross-Straits liberalization after the elections, they were far from confident that meaningful cross-Straits banking liberalization would occur anytime soon. Long term prospects were extremely good, commented Lin, who predicted that within ten years "it would all be sorted out."

¶10. (C) At the September 27 dinner, Taiwan Stock Exchange (TSE) President Song-Chin Su emphasized his interest in ensuring that the TSE improve its competitiveness by adopting international standards, including in the area of corporate

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governance. Taishin's Lin and Fubon's Ding were both critical of the Chen administration's economic stewardship, and argued strongly in favor of increased cross-Straits economic integration. In general, authorities and private sector contacts agreed that Taiwan's economic future lies in removing restrictions on cross-Straits economic relations. There was broad recognition that regardless of who wins the March 2008 presidential election, political considerations will slow the reform process.

#### Financial Sector Reform Draws Mixed Reviews

¶11. (C) On financial market liberalization, Finance Vice Minister Liu noted that state-owned banks now account for half of Taiwan's banking market, and the authorities continue to adhere to a long-term goal of total banking sector privatization. Liu noted that continued progress toward privatization will be slow, due in part to lack of Legislative Yuan (LY) approval and strong labor union opposition. In the short term, explained Liu, the authorities plan to sell three of the six remaining state-owned banks. Private sector contacts were largely pessimistic about the authorities' ability to move ahead quickly on this "second stage" financial sector reform. Although Taishin's Lin maintained that Taiwan has implemented a "quiet revolution" and now has a relatively open financial sector, Fubon's Ding, in contrast, was less sanguine, speculating that Taiwan's relative stability during the 1997-98 Asian financial crisis may have dulled the impetus for the more aggressive liberalization reforms adopted by South Korea and other regional economies affected by the crisis.

¶12. (C) COMMENT. The Treasury visit was useful in offering a deeper sense of cross-Straits economic integration's impact on the Taiwan economy, as well as a broader view of the Taiwan policy community's efforts to address growing concerns about Taiwan's eroding economic competitiveness. END COMMENT.

¶13. (U) This message has been cleared by Haarsager.  
YOUNG